

Report of the auditor-general to Free State Legislature and the council on the Kopanong Local Municipality

Report on the audit of the financial statements

Qualified opinion

1. I have audited the financial statements of the Kopanong Local Municipality set out on pages ... to ..., which comprise of the statement of financial position as at 30 June 2017, statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual information for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion section of my report, the financial statements present fairly, in all material respects, the financial position of the Kopanong local municipality as at 30 June 2017, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003)(MFMA) and the Division of Revenue Act of South Africa, 2016 (Act No. 3 of 2016)(Dora).

Basis for qualified opinion

Receivables from exchange transactions

3. Gross receivables from exchange transactions disclosed in note 9 to the financial statements were not assessed for impairment as per the requirements of GRAP 104 *Financial instruments*. The municipality only made a general provision and did not consider whether objective evidence exists that individually significant receivables and/or a group of receivables with similar credit risk characteristics is collectively impaired. As the relevant information pertaining to the estimated future cash flows was not available, I was not able to determine the impact on the net amount for receivables from exchange transactions, as it was impracticable to do so. Furthermore, I was unable to obtain sufficient and appropriate audit evidence for the difference noted between the gross debtors' amounts per the financial statements and the gross debtors' amounts used in the impairment calculation. Additionally, there was a resultant impact on debt impairment as disclosed in note 27 to the annual financial statements. Consequently, I was unable to determine whether any further adjustments were necessary to receivables from exchange transaction stated at R26 182 516 in the financial statements.
4. The municipality incorrectly calculated interest on overdue accounts at a rate contrary to the approved tariffs of the council. Consequently, receivables from exchange transactions as disclosed in note 9 to the financial statements is understated by R4 844 418 and interest received income understated by a similar amount.

Receivables from non-exchange transactions

5. Gross receivables from non-exchange transactions as per note 7 to the financial statements were not assessed for impairment as per the requirements of GRAP 104 *Financial instruments*. The municipality only made a general provision and did not consider whether objective evidence exists that individually significant receivables and/or a group of receivables with similar credit risk characteristics are collectively impaired. As the relevant information pertaining to the estimated future cash flows was not available, I was not able to determine the impact on the net amount for receivables from non-exchange transactions, as it was impracticable to do so.

Payables from exchange transactions

6. I was unable to obtain sufficient appropriate audit evidence for payment received in advance of R10 573 658 as disclosed in note 14 to the financial statement, as I could not determine whether there were any obligations towards the debtors. I could not confirm the payments in advance by alternative means. In addition, differences were identified between third-party statements and the salary payables, resulting in trade and other payables from exchange transactions being overstated by R9 234 873 and employee cost overstated by the same amount. Furthermore, I was unable to obtain sufficient appropriate audit evidence for retention, as internal controls had not been established for the recognition of retention as well as the difference between the payables listing and ledger. Consequently, I was unable to determine whether any further adjustments were necessary to trade and other payables from exchange transactions stated at R291 442 675 in the financial statements.
7. The municipality incorrectly recorded the payables owed to the electricity service organisation against the accumulated surplus account. Consequently, payables from exchange transactions were understated by R17 912 200 and accumulated surplus was overstated by the same amount.

Statement of changes in net assets

8. I was unable to obtain sufficient appropriate audit evidence for the restated opening balance of accumulated surplus, as the supporting information was not provided. I was unable to confirm the opening balance by alternative means. Consequently, I was unable to determine whether any further adjustment was necessary to the restated opening balance of accumulated surplus stated at R734 651 249 in the financial statements.

Cash flow statement

9. The municipality did not present the cash flow statement in accordance with SA Standards of GRAP, GRAP 2, *Cash flow statements*. The cash flows from operating activities and financing activities are misstated, resulting in the cash flow statement being misstated by R11 965 748.

Unauthorised expenditure

10. The municipality did not calculate unauthorised expenditure as disclosed in note 41 in the current year per vote, as a result I was unable to obtain sufficient appropriate audit evidence in the current year for unauthorised expenditure of R67 387 246. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustment was necessary to the current year unauthorised expenditure stated at R67 387 246 in note 41 to the financial statements.

Context for the opinion

11. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of my report.
12. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
13. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Material uncertainty related to going concern

14. I draw attention to the matter below. My opinion is not modified in respect of this matter:

Note 37 in the financial statements, which indicates that the municipality incurred a net loss of R88 078 861 (2016: R83 839 942) during the year ended 30 June 2017 and, as of that date, the municipality's current liabilities exceeded its current assets by R274 070 938 (2016: R207 072 996). The municipality has been deducting pay as you earn taxes, pension fund and medical aid funds from employees' salaries, but has been unable to pay over R59 130 474 (2016: R36 176 724) of these amounts deducted to the relevant third parties as disclosed in note 13: payables from exchange. In addition, the municipality owed the water board R195 408 466 as at 30 June 2017, which was long overdue and was included with trade payables disclosed in note 14 to the financial statements. These conditions, along with other matters as set forth in note 37 indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern and to meet its service delivery objectives.

Emphasis of matters

15. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

16. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2016 have been restated as a result of errors discovered during 2016-17 in the financial statements of the municipality at, and for the year ended, 30 June 2016.

Material losses

17. As disclosed in note 48 to the financial statements, material electricity losses of R8 278 827 and water distribution losses of R13 512 953 were incurred by the municipality, mainly due to the ageing electricity and water infrastructure.
18. As disclosed in note 20 to the financial statements, the municipality had foregone revenue of R25 356 246 (2016: R23 509 404) due to the council's exemption policy on property rates charged during the financial year.
19. As disclosed in note 9 to the financial statements, material debtors balances were written off against the impairment provision of R25 564 493 (2016: R14 728 561) as a result of a write-off of irrecoverable receivables from exchange transactions.

Material underspending of the water service infrastructure grant

20. As disclosed in the note 21 to the annual financial statements, the municipality has materially underspent the budget on the water service infrastructure grant to the amount of R13 108 185 due to a pending court case.

Material impairments

21. As disclosed in note 7 to the financial statements, receivables from non-exchange transactions were impaired by R20 415 343 (2016: R15 207 530) and, as disclosed in note 9 to the financial statements, receivables from exchange transactions were impaired by R141 726 849 (2016: R124 812 509).

Irregular expenditure

22. As disclosed in note 43 to the financial statements, the municipality incurred irregular expenditure of R30 557 049 (2016: R25 074 130) during the year due to non-compliance with supply chain management requirements. In addition, the full extent of irregular expenditure during the year was still in the process of being determined.

Fruitless and wasteful expenditure

23. As disclosed in note 42 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R24 185 847 (2016: R19 155 122) during the year due to interest and penalty charges on the late payment of suppliers.

Other matter

24. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

25. In terms of section 125(2) (e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

Responsibilities of the accounting officer for the financial statements

26. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with SA Standards of GRAP and the requirements of the MFMA and Dora, and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

27. In preparing the financial statements, the accounting officer is responsible for assessing the Kopanong Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless there is an intention to liquidate the municipality or to cease operations, or there is no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

28. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

29. A further description of my responsibilities for the audit of the financial statements is included in the annexure to the auditor's report.

Report on the audit of the annual performance report

Introduction and scope

30. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected key performance areas (KPA's) presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.

31. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
32. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected KPAs presented in the annual performance report of the municipality for the year ended 30 June 2017:

Development priorities	Pages in the annual performance report
Service delivery and infrastructure development – Technical services	x – x
Service delivery and infrastructure development – Community services	x – x

33. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
34. The material findings in respect of the usefulness and reliability of the selected KPAs are as follows:

KPA 1 – Service delivery and infrastructure development – Technical services

Various indicators

35. I was unable to obtain sufficient appropriate audit evidence for the reported achievement of indicators listed below. This was due to inadequate technical indicator descriptions and/or formal standard operating procedures or documented systems descriptions that predetermined how the achievement would be measured, monitored and reported, as required by the Framework for managing programme performance information (FMPPI). I was unable to confirm that the reported achievement of this indicator was reliable by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement.

Indicator	Reported achievement
• KPI 1 – 20% construction of concrete 3 mgl reservoir and distribution of 3 km water pipeline in Trompsburg by 30/06/17	5%
• KPI 2 – 80% construction of elevated tank and 3 km bulk supply pipeline in Reddersburg by 30 June 2017	0

Indicator	Reported achievement
• KPI 11 – 60% construction of the transfer station site in Fauresmith by 30 June	60%
• KPI 11 – 15% construction of the transfer station site in Reddersburg by 30 June	5%

36. The performance indicator was not clearly defined as it contained an ambiguous definition, where the performance was limited to monitoring work as opposed to when the actual work was done by other departments, which can be misleading, and this is contrary to the requirement of the FMPPI. This could be attributed to a lack of understanding of the relevant guidelines in setting performance indicators and targets that are specific, measureable, achievable, relevant and time bound.

Indicator	Reported achievement
• KPI 3 – Upgrading of 3 km rising main pipeline in Phillippolis by 28 February 2017	1
• KPI 5 – 47 quarterly maintenance of boreholes	0
• KPI 7 – Construction of new 200 mm sewer pipe over the length of 3km in Fauresmith by 28 February 2017	0
• KPI 8 – Construction of new 200 mm steel pipe over the length of 3 km in Philippolis by 28 February 2017	0

KPA 2 – Service delivery and infrastructure development – Community Service

Various indicators

37. The performance indicator and target was not well defined as it did not allow for consistency of data collection, as the indicator and the target are not reading the same, which is contrary to the requirement of the FMPPI. This was due to inadequate technical indicator descriptions and/or formal standard operating procedures or documented systems descriptions that pre-define how the achievement would be measured, monitored and reported, as required by the FMPPI. I was unable to confirm that the reported achievement of this indicator was reliable by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement.

Indicator	Reported achievement
• KPI 1 – Connections of water to 20 household	0
• KPI 2 – Connections of sewerage to 21 (0,2%) households	0
• KPI 3 – Electricity connections to 196 households by June 2017	0
• KPI 12 – Identification of illegal dumping in all nine towns and place signage	0

Other matters

38. I draw attention to the matters below.

Achievement of planned targets

39. Refer to the annual performance report on pages x to x and x to x for information on the achievement of planned targets for the year and explanations provided for the underachievement of a significant number of targets. This information should be considered in the context of the qualified opinions expressed on the usefulness and reliability of the reported performance information in paragraph(s) x, x and x of this report.

Adjustment of material misstatements

40. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of KPA – service delivery and infrastructure development – Technical services and service Delivery and infrastructure development – community service as management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information.

Unaudited supplementary schedules

41. The supplementary information set out on pages x to x does not form part of the annual performance report and is presented as additional information. We have not audited these schedules and, accordingly, we do not express a conclusion on them.

Report on audit of compliance with legislation

Introduction and scope

42. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the type of auditee] with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

The material findings in respect of the compliance criteria for the applicable subject matters are as follows:

Budget

43. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R48 162 721 (2016: R95 552 999), as disclosed in note 39 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA.

Annual financial statements and annual performance report

44. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of current assets, current liability and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and/or

supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

45. The annual performance report for the year under review did not include a comparison of the performance with set targets and comparison with the previous financial year and measures taken to improve performance for each service provider, as required by section 46(1)(b) of the MSA.

Expenditure management

46. Money owed by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
47. Effective steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by changes made to criteria or differing criteria applied than what was published. Irregular expenditure amounting to R30 557 049 was incurred on most of the projects awarded during the financial year.
48. Effective steps were not taken to prevent fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA. Fruitless and wasteful expenditure amounting to R24 135 348 was incurred on mainly Bloemwater outstanding invoices not paid.

Revenue management

49. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.

Asset management

50. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.
51. Capital assets were permanently disposed of without the approval of the council and as required by section 14(2)(a) of the MFMA.

Liability management

52. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the MFMA.

Procurement and contract management

53. Some of the contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of SCM regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations. Similar non-compliance was also reported in the prior year.
54. Some of the contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43.

55. Some of the contracts were awarded to bidders based on preference points that were not allocated or calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
56. Some of the contracts were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act and preferential procurement regulations.
57. Some of the contracts were awarded to bidders based on functionality criteria that differed from those stipulated in the original invitation for bidding, in contravention of preferential procurement regulation 4.
58. Some of the construction contracts were awarded to contractors that did not qualify for the contract in accordance with section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A). Similar non-compliance was also reported in the prior year.
59. Some of the contracts were extended or modified without the approval of a properly delegated official, in contravention of SCM regulation 5.
60. The performance of some of the contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
61. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA.

HR management

62. Appropriate systems and procedures to monitor, measure and evaluate performance of staff were not developed and adopted as required by section 67(1)(d) of the MSA.

Utilisation of conditional grants

63. The water service infrastructure grant was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of the Division of Revenue Act.

Consequence management

64. Unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(b) of the Municipal Finance Management Act.

Other information

65. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report thereon and those selected KPAs presented in the annual performance report that have been specifically reported on in the auditor's report.

66. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
67. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected KPAs presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work I have performed on the other information obtained prior to the date of this auditor's report, I conclude that there is a material misstatement of this other information, I am required to report that fact.
68. I have not yet received the annual report. When I do receive this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected I may have to re-issue my auditor's report amended as appropriate.

Internal control deficiencies

69. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
70. The leadership did not sufficiently oversee financial and performance reporting and compliance and related internal controls, as it did not ensure that there were sound controls in the daily operations of the municipality.
71. There has been a slow response from the leadership to implementing and monitoring the audit action plan to address qualification areas and internal control deficiencies identified during the previous audits. As a result, addressing these deficiencies was again a last minute effort to avoid audit report matters.
72. The leadership did not take effective steps to ensure that there were consequences for poor performance and transgressions, as none of the unauthorised, irregular, and fruitless and wasteful expenditure was investigated during the financial year.
73. Management did not implement proper record keeping and prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information. This was due to the lack of consequence management, for competent staff that did not perform in line with their responsibilities and level of competencies, at the financial department and in the performance information division.
74. The municipality did not prioritise the review and monitoring of compliance with legislation, which resulted in repeat findings being reported.

75. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing. Numerous repeat findings were identified, which we communicated to the municipality and were corrected by management during the audit process. These corrections resulted in material amendments to the financial statements.
76. The effectiveness of the audit committee and internal audit was impeded, as could be seen from the issues identified by the audit not being given appropriate audit coverage. These issues therefore could not influence an improvement in the municipality's control environment. Furthermore, steps taken by management to address internal control deficiencies and emerging audit risks identified in the previous audit were not adequately monitored.

Other reports

77. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.

Investigations

78. The municipality is still awaiting a report from the special investigations unit (SIU) relating to several issues of non-compliance with the municipal policies. As reported previously, at the time of this report, the SIU had not yet reported back to the municipality on these issues and according to information obtained from the SIU, the report on proclamation 58/2011 had already been completed and issued to the President.

Bloemfontein

30 November 2017



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general's responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected KPAs and on the municipality's compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in the auditor's report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control.
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.
 - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Kopanong Local Municipality's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of the auditor's report. However, future events or conditions may cause a municipality to cease to continue as a going concern.
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and here applicable, related safeguards.